

HM Treasury Consultation

Tobacco Tax Levy (closing date 18th February 2015)

Response from Action on Smoking and Health

ASH (UK) is a health charity set up by the Royal College of Physicians in 1971 working towards the elimination of harm caused by tobacco. ASH receives core funding from the British Heart Foundation and Cancer Research UK and has received project funding for work to support government tobacco strategy for England from the Department of Health. ASH does not have any direct or indirect links to, or receive funding from, the tobacco industry.

Please note: This document is informed by two additional supporting reports. A research report for ASH by Howard Reed, Landman Economics, “*A UK Tobacco Levy: The options for raising £500 million per year*” (January 2015), and a report on “*The Extreme Profitability of the UK Tobacco Market*”, by Branston and Gilmore, copies of which are attached.

General Observations

Summary

1. ASH warmly welcomed the Chancellor’s announcement in the Autumn Statement that the Government is minded to introduce a levy on tobacco manufacturers and importers. We strongly agree with the Chancellor’s observation that: “*Smoking imposes costs on society, and the Government believes it is therefore fair to ask the tobacco industry to make a greater contribution.*”¹
2. Tobacco manufacturers and importers in the UK are immensely profitable, such that it could certainly afford to make a greater contribution. Recent research by Branston and Gilmore at the University of Bath suggests that in the UK the industry has made at least £1 billion in profits in each of the last 5 years, that this profitability has been increasing during the period of analysis, and that the profitability is likely to be in the region of £1.5bn in recent years. Tobacco manufacturers and importers are also found to enjoy consistently high profit margins of up to 68%, compared to only 15-20% in most consumer staple industries.
3. Preventing the industry from passing on the cost of any levy would require price controls. It is not clear that this would be technically feasible in the light of the current EU Tobacco Tax Directive.² However, even if the industry did pass on the full cost of any levy, the public would support such additional taxation if it were spent on measures to prevent youth uptake and encourage smokers to quit. Indeed there is overwhelming public support for a levy which would raise an additional £500 million and majority support from smokers if it were to be used for such purposes. If any money raised simply went into the Consolidated Fund this would be an unfair additional burden on smokers, who are predominantly amongst the poorest and most disadvantaged in society.
4. We strongly support a levy to raise this amount of money to be used for tobacco control. At the same time we recommend that the industry be required to provide data on sales down to local level which could be published at an aggregated level to inform public

¹ [HM Treasury Autumn Statement](#) December 2014, paragraph 2.252

² EU Tobacco Tax Directive Article 15.

health policy. The industry should also be required to provide data on marketing spend, including corporate social responsibility and lobbying activity and on its profitability within the UK.

5. The EU Tobacco Tax Directive is due for review shortly. We recommend that the UK government advocate for revisions which would enable the introduction of a price capping mechanism. Placing a cap on industry profit would enable the excess profit to be transferred from the manufacturer to government, and prevent it simply being passed on to the consumer, so fulfilling the objective of ensuring that the industry pays a greater contribution to the costs it imposes on society.³

Background

6. As quoted in the consultation document, Action on Smoking and Health estimate that the total cost of smoking to society in England alone is approximately £12.9 billion a year.⁴ This is likely to be an under-estimate as only costs where data is attributable have been included. For example it did not include the cost of collecting smoking-related litter. The following costs are included:
 - £2 billion cost to the NHS of treating diseases caused by smoking
 - £3 billion loss in productivity due to premature death
 - £5 billion cost to businesses of smoking breaks
 - £1 billion cost of smoking-related sick days
 - £1.1 billion of social care costs of older smokers
 - £391 million cost of fires caused by smokers' materials
7. The costs to society are expressed in financial terms but underlying this are the severe financial and personal costs both to the smoker and their loved ones due to the death and disease caused by tobacco.
8. Tobacco taxation already raises around £9.5 billion in excise tax for the Consolidated Fund, money which comes from the pockets of smokers, plus a further £2.5 billion in VAT. The Office for National Statistics estimates that the total UK household expenditure on tobacco in 2013 was £18.7 billion. For 2014, a 20-a-day smoker of a premium cigarette brand will spend about £2,900 over the year on cigarettes.⁵
9. The tobacco industry enjoy massive profit margins in the UK and would be very well able to make more of a contribution.^{3 6} And, of course they may well decide to pass on to consumers some or all of the cost. If any of the levy is passed on in the form of higher prices, this will have some public health benefits, since price increases are an effective policy lever in reducing smoking prevalence. Estimates of the price elasticity of cigarettes and tobacco products vary, but in 2002 the World Bank estimated that in rich countries such as the UK, a 10% increase in the price of cigarettes will reduce tobacco

³ Gilmore A, Branston JR, and Sweanor D. The case for OFSMOKE: how tobacco price regulation is needed to promote the health of markets, government revenue and the public. Tobacco Control 2010 19: 423-430

⁴ [ASH Ready Reckoner](#). ASH and LeLan Solutions, Sept. 2014

⁵ *ibid*

⁶ Branston JR and Gilmore A. The case for Ofsmoke: the potential for price cap regulation of tobacco to raise £500m per year in the UK. Tobacco Control 2014; 23(1): 45-50

consumption by 4%.⁷ A comprehensive review of the literature published since this date by IARC in 2011 concludes that based on aggregate demand studies, price elasticity remains around -0.4 in high income countries including the UK.⁸

10. There is widespread support in England for the idea of putting the equivalent in today's prices of 25 pence on a packet of cigarettes with the funds being used to fund tobacco control; 78% of the adult population is in favour of the idea including 54% of those in Social Grade E ('unemployed, on state benefit and lowest grade workers') who had smoked in the past year and 52% of these who were smoking at the time of the survey.⁹ This could raise around £500 million (see table 1 below). Similar support is found in surveys across Europe.¹⁰
11. Fewer than one in five adults now smoke, but smoking prevalence rates are much higher among poorer people. In 2013, 14% of adults in managerial and professional occupations smoked compared with 29% in routine and manual occupations. Tobacco use is by far the greatest single factor in health inequality, accounting for about half the difference in life expectancy between social classes.¹¹
12. Poorer smokers are more sensitive to price increases than better off smokers. So, increasing price through taxation is potentially a progressive rather than regressive measure which can help reduce health inequalities at population level.¹² However, poorer smokers who don't quit are disproportionately disadvantaged because of the negative impact of tobacco tax increases on their already small incomes.
13. Therefore the benefits to public health will only be fully realised if a proportionate amount of the proceeds of the levy are used to fund tobacco control action designed to increase the rate of quitting tobacco use, and prevent uptake among young people, over and above what might be expected as a result of any price rises. This is not only fair and equitable to smokers and popular both with smokers and the general public, but vital if the societal harm caused by tobacco is to be eliminated. Indeed comprehensive measures to reduce smoking prevalence are essential to reducing inequality and improving the nation's health.
14. It should be noted that the latest NHS Five Year Forward View for England, published in October 2014, includes a section called "Getting serious about prevention", which states that:
"The future health of millions of children, the sustainability of the NHS, and the economic prosperity of Britain all now depend on a radical upgrade in prevention and public health... We do not have to accept this rising burden of ill health driven by our lifestyles, patterned by deprivation and other social and economic influences..."

While the health service certainly can't do everything that's needed by itself, it can and should now become a more activist agent of health-related social change. That's why we will lead where possible, or advocate when appropriate, a range of new approaches to improving health and wellbeing...

⁷ [Economics of Tobacco Toolkit](#) World Bank 2002

⁸ International Agency for Research on Cancer. IARC Handbooks of Cancer Prevention. Tobacco Control Volume 14. Effectiveness of Tax and Price Policies for Tobacco Control. Lyons: IARC, 2011

⁹ West R. Public support for a tobacco levy. Smoking Toolkit Study. 2006

¹⁰ [Policy Recommendations for Tobacco Taxation in the European Union. Integrated research findings from the PPACTE project.](#) 2012

¹¹ [Smoking and Health Inequalities](#) Action on Smoking and Health

¹² The World Bank. Curbing the epidemic: governments and the economics of tobacco control. May, 1999.

For all of these major health risks – including tobacco, alcohol, junk food and excess sugar – we will actively support comprehensive, hard-hitting and broad-based national action to include clear information and labelling, targeted personal support and wider changes to distribution, marketing, pricing, and product formulation...”¹³

15. Tobacco smoke is a legal pollutant. But this does not exempt the polluter from paying the costs of the pollution it causes. There is already a major industry in the UK that pays to reduce the legal pollution caused by its everyday business: the energy industry. The Energy Company Obligation (ECO) places a legal requirement on energy companies to invest in energy efficiency measures, especially for poor and vulnerable households. The principal component of the ECO, the Carbon Emissions Reduction Obligation, makes explicit the statutory obligation on the industry to reduce environmental pollution by reducing demand for its core product.
16. A Tobacco Company Obligation would follow the same logic. The pollution and harm caused by smoking cannot be eliminated overnight by prohibition or technological innovation, just as carbon-intensive energy sources cannot be banned or, in the short-term, entirely substituted by renewable technologies. So, just as the considerable profits of the energy companies allow for investment in interventions to reduce demand for energy, it is right and proper for government to draw on the excessive profits of the tobacco industry to reduce demand for tobacco products. However, in line with our obligations as a party to the WHO FCTC and in particular Article 5.3, the tobacco industry could have no control over this money, or how it should be allocated.¹⁴
17. This is not a new idea in tobacco control. In the United States, the Family Smoking Prevention and Tobacco Control Act 2009 requires the tobacco industry to pay an annual ‘user fee’ to the Food and Drug Administration (FDA) to fund tobacco regulation and wider tobacco control activity.¹⁵ This levy is independent of the wider US fiscal regime and its proceeds are controlled directly by the FDA. The total value of the levy is based on a calculation of the costs of tobacco regulation, which is then apportioned to tobacco companies according to their market share in the US.
18. International evidence shows that public investment in policies designed to reduce smoking prevalence is likely to prove highly cost-effective in the long run. For example the 2014 US Surgeon General Report, “The Health Consequences of Smoking – 50 Years of Progress”, reports that *“States that have made larger investments in comprehensive tobacco control programs have seen larger declines in cigarettes sales than the nation as a whole, and the prevalence of smoking among adults and youth has declined faster, as spending for tobacco control programs has increased.”* The Report also finds that long term investment is critical. It states, *“Experience also shows that the longer the states invest in comprehensive tobacco control programs, the greater and faster the impact.”*¹⁶
19. In reducing smoking prevalence rates in the UK, an essential role is played by tobacco control measures carried out by local authorities, for example the stop smoking services. The Department of Health document “Local Stop Smoking Services: service delivery and

¹³ [NHS: Five Year Forward View](#) NHS England, October 2014

¹⁴ WHO FCTC. Article 5.3 guidelines.

¹⁵ [Family Smoking Prevention and Tobacco Control and Federal Retirement Reform](#). 123 Stat. 1776 Public Law 111–31—June 22, 2009. Section 919 user fees.

¹⁶ U.S. Department of Health and Human Services: [The Health Consequences of Smoking: 50 Years of Progress](#): A Report of the Surgeon General, Atlanta, GA: U.S. Department of Health and Human Services

monitoring guidelines 2011-12” stated that: “*Stop smoking services are a key part of tobacco control and health inequalities ... Evidence-based stop smoking support is highly effective both in cost and clinical terms. It should therefore be seen in the same way as any other clinical service and offered to all smokers.*”¹⁷

20. However, these services are vulnerable, following the transfer of the public health function to local authorities under the Health and Social Care Act 2012, because of the exceptionally tight public spending regime that local authorities now face. There are already grounds for concern about how many people are being reached by stop smoking services. The Health and Social Care Information Centre reports that, from the beginning of April 2013 to the end of March 2014, 586,337 people set a quit date through the NHS Stop Smoking Services, but that this figure was down 19 per cent on those for 2012/13. 300,539 people successfully quit (down 20 per cent) giving a quit rate of just over half, similar to 2012/13.
21. It should be noted that, although stop smoking services are demonstrably cost-effective and benefit the local economy, apart from social care costs, much of the direct savings they deliver accrue mainly to the NHS and not by the increasingly cash-strapped local authorities that have to pay for the services. This point also applies to local action by trading standards officers and others to reduce the scale of the illicit tobacco trade. The Exchequer gains financially from its investment in measures by HMRC to tackle tobacco smuggling through revenue loss prevention, but local authorities do not.
22. Although the level of illicit trade has fallen sharply since 2000, it remains unacceptably high and the latest figures from HM Revenue and Customs suggest that it has risen slightly from a low point in 2012/13. In 2013/14 an estimated 10% of cigarettes consumed in the UK were illicit compared to 9% in 2012/13. The figures for hand-rolled tobacco (HRT) were 39% in 2013/14 compared to 36% in 2012/13 (all figures mid-range estimates).¹⁸ Detailed recommendations on how to improve action against illicit trade have been made by both the National Audit Office¹⁹ and the House of Commons Home Affairs Select Committee.²⁰ ASH strongly supports these recommendations which include specific recommendations on increasing local and regional action against illicit trade that would require financial contributions from local authorities to be implemented.
23. Mass media and social marketing campaigns can also be highly effective in stimulating quitting behaviour but require significant investment in order to be most effective.^{21 22 23}
24. **We therefore consider it essential that the imposition of the tobacco levy be accompanied by a specific spending announcement on how a proportion of the proceeds of the levy will be used to help fund a comprehensive strategy to reduce**

¹⁷ [Local Stop Smoking Services: service delivery and monitoring guidance 2011-2012](#): Executive Summary page 5 Department of Health 2011

¹⁸ [HMRC Tobacco Tax Gaps Estimates 2013/14](#)

¹⁹ [National Audit Office: Progress in tackling tobacco smuggling](#). Report published 6 June 2013, and [Public Accounts Committee - Twenty-Third Report HM Revenue and Customs: Progress in tackling tobacco smuggling](#) Report published 4th September 2013.

²⁰ [Home Affairs Select Committee: First Report, Tobacco Smuggling](#). 11th June 2014

²¹ Wakefield M et al. Impact of Tobacco Control Policies and Mass Media Campaigns on Monthly Adult Smoking Prevalence. *Am J Public Health*. 2008 August; 98(8): 1443–1450.

²² Langley T, McNeill A, Lewis S, Szatkowski L, Quinn C. The impact of media campaigns on smoking cessation activity: a structural vector autoregression analysis. *Addiction* 2012;107(11): 2043-2050

²³ Sims M, Salway R, Langley T, Lewis S, McNeill A, Szatkowski L, Gilmore A. Effectiveness of mass media campaigns to change tobacco use in England: a population-based cross-sectional study. *Addiction* 2014; 109(6): 986-94.

the harm caused by tobacco. Such a strategy, at a rough estimate, would cost no more than £500 million a year, and would include key measures such as:

- **supporting tobacco control measures at regional and local level, for example to fund action against the illicit tobacco trade outside of HMRC;**
- **ensuring the provision of high quality Stop Smoking Services across the country; and**
- **financing mass media and social marketing campaigns, which add value to other tobacco control initiatives.**

25. We would also strongly suggest that this portion of the levy be established along similar lines to the US “user fee”, so that it is effectively made independent of the wider fiscal regime and so that appropriate means can be found to ensure that disbursement of the proceeds on tobacco control can be informed by the best available evidence, completely independent from any influence by the tobacco industry. We believe that such an arrangement would impose minimal bureaucratic costs and would also be consistent with the UK’s obligation under Article 5.2 of the Framework Convention on Tobacco Control to *“establish or reinforce and finance a national coordinating mechanism or focal points for tobacco control”*.

26. It should be noted that as of 31st March 2014, the US Food and Drug Administration had collected \$1.88 billion in manufacturer user fees since 2009 and has spent \$1.48 billion of that amount over the past five years. Of the \$1.48 billion spent so far, \$508 million, or just over half a billion dollars, has been spent on public education and \$449 million has been spent on scientific research projects that will form the foundation for additional FDA regulations on tobacco products.²⁴

Answers to Consultation Questions

Question 1: Is it appropriate to define the tobacco market as products on which tobacco excise duty is paid?

27. We support this definition of the tobacco market. It would be relatively simple to administer compared to any reasonable alternative, and it would maximise the benefits to public health, since smoking “herbal cigarettes” as opposed to tobacco products also carries major health risks.

Question 2: What would be the consequences of using volumes of tobacco cleared in the previous year in order to calculate total market size?

Question 3: Are there any other metrics that you would prefer were used to calculate total market size? If so, why?

28. We would support the levy being introduced on the basis of a calculation based on previous year clearances. However, we would note that the level of clearances is routinely manipulated by the tobacco industry through the process known as forestalling.

29. *“Forestalling”* in this context means a temporary increase in the clearance of rate of cigarettes and other tobacco products, for example so that they can be released into the

²⁴ [General Accounting Office reports FDA tobacco user fee spending](#). Accessed 16 January 2015

UK market immediately preceding the Budget, with the intention that duty paid on these products will be at the lower pre-Budget rate. This is of course generally followed by lower than average release of products in the month of so after the Budget. Forestalling can reduce the total tax revenue from tobacco raised in any given year, as well as potentially undermining the potential public health gain from increases in tobacco taxation, since it can delay the effective date of tax increases and therefore any consequential price rises. The recent extent of forestalling is well illustrated by HMRC's Tobacco Bulletin for November 2013, which shows a spike in tax receipts in April levied at the pre-budget rate, followed by a sharp drop in May, for the financial years 2011/12, 2012/13, and 2013/14. It should be noted that this pattern is present for tax receipts from home produced cigarettes, imported cigarettes, cigars, hand rolling tobacco, and other tobacco products.²⁵

30. Use of previous year clearance data would help to minimise the effect of forestalling. However, we believe that the best possible basis on which to raise a tobacco levy would be sales volumes and prices by brands, disclosed at a local, regional and national level. This would make industry manipulation of the figures much more difficult, and, crucially, would also enable the disbursement of proceeds of the levy to fund tobacco control work in a way that was sensitive to local consumption and prevalence levels and the consequent harm caused. We believe that the tobacco industry already has much more sales data than it currently discloses. In addition, the industry will be progressively required to collect, hold and disclose such data as part of the tougher supply chain controls envisaged in the revised EU Tobacco Products Directive and the Illicit Trade Protocol.^{26 27} For example, an effective tracing system for tobacco products, mandated under Article 15 of the Directive and Article 8 of the Protocol, would require that cigarette packs and other tobacco packaging carry a “*unique identifier*” that would allow enforcement authorities to access detailed information about the manufacturing process and intended market.
31. Assuming that the tobacco levy would be a reserved matter for the Westminster Parliament (at least in the first year), revenue should be distributed to the UK administrations in accordance with the proportion of the total number of UK smokers in each jurisdiction. If the levy were set at a level to raise £500 million, as we suggest, we estimate that the distribution would be as shown in the table below. We see this resource being distributed according to the evidence at national, regional and local level.

Table 1: Suggested allocation of revenue from tobacco levy across the countries of the UK

Country	Proportion of smokers in the UK (%)	Funding allocation (£m)
England	82.5	412.6
Wales	5.1	25.7
Scotland	9.6	47.9
Northern Ireland	2.8	13.8
TOTAL	100.0	500.0

Notes: Statistics for adult smoking prevalence in each country in the UK taken from 2013 Integrated Household Survey. Adult population totals in each country: mid-2013 estimates.

²⁵ [HM Revenue and Customs: Tobacco Bulletin, August 2014](#)

²⁶ [EU Revised Tobacco Products Directive](#) 3 April 2014

²⁷ [Protocol to Eliminate Trade in Tobacco Products](#): World Health Organisation 2013

32. In summary, we recommend that:

- Previous year clearance data be used as the basis on which to raise the levy in year one.
- The Chancellor takes powers in primary legislation to change the basis on which the levy is raised in future years by Order, with a view to shifting towards sales data in parallel with the introduction of mandated supply chain controls under the EU Directive and WHO Protocol.
- That proceeds of the levy to be spent on tobacco control and enforcement are distributed in a way that reflects local prevalence rates, to ensure that money is focussed on areas of greatest need.
- That the proceeds of the levy be distributed to the devolved administrations in a ratio determined by the proportion of the total number of UK smokers in each jurisdiction.

Question 4: What are the practical difficulties in splitting the total market into 2 distinct parts: cigarettes; and HRT and other products subject to tobacco duty?

33. As HRT is sold by weight rather than number of cigarettes or equivalents, it would presumably be necessary to calculate the level at which the levy on HRT would be set based on an assumption about the weight of tobacco in a typical hand rolled cigarette.

34. The HMRC Tobacco Bulletin for October 2014 reports that in the 2013/14 tax year:

- 35.4 billion cigarettes were released for consumption
- 7.1 million kilos of other tobacco products were release for consumption (more than 90% being HRT)

35. A recent study of HRT consumption in 18 European countries gives a tobacco content of a typical hand-rolled cigarette as 0.75 grams.²⁸ This is the basis on which we have calculated the levy on HRT over five years in the table in paragraph 43 below.

Question 5: Which of option (i) and (ii) as set out in paragraph 2.14 is your preferred option?

36. For the reasons stated in paragraphs 28 to 30 above, we prefer the initial use of previous year clearance data, at the start of the levy, with evolution towards use of sales volume data.

Question 6: Do you agree that the corporation tax system provides the best mechanism for returning and paying the tobacco levy?

Question 7: What are the alternative approaches?

37. In principle the use of the corporation tax system to collect the levy is a good idea, as the system would not impose an additional administrative burden. We assume that the Treasury would construct levy rules so that levy payments *and any associated*

²⁸ Joossens L, Lugo A, La Vecchia C, Gilmore A, Clancy, L and Gallus S. 2012 [Illicit cigarettes and hand-rolled tobacco in 18 European countries: a cross-sectional survey Tobacco Control, Online First.](#)

administrative or other costs to the tobacco industry could not be used to reduce liability for corporation tax.

38. However, as different companies have different year ends there is a possibility that the industry could game the system by timing its clearances. An alternative to be considered would be to use the excise tax system.

Question 8: The government welcomes views on the expected impacts of the levy on consumer prices.

Question 9: Would the levy have any other impacts on consumers that have not been considered in this document?

Question 10: Would the levy have any other market impacts?

39. The impact of the levy on prices will depend on two related factors:

- The effect on brand value and differentiation of the (assumed) introduction of standardised packaging under the Children and Families Act 2014, and
- The proportion of the levy that manufacturers decide to pass on in the retail price of cigarettes and other tobacco products.

40. According to the Department of Health Impact Assessment on standardised packaging ²⁹ (paragraph 90), *“On the assumption that all cigarette packets cost broadly the same to produce, the difference in profit between a pack of 20 in one of the top two price brands as opposed to the bottom two price brands is around £0.65.”*

41. We consider it likely that the effect of standardised packaging over time will be to reduce the differential in retail prices between “luxury” and “economy” brands. We assume that the likely result will be retail prices converging on what is now the average price level.

42. The research paper attached to this consultation response written by Howard Reed, Landman Economics, includes the following table on the impact of a tobacco levy intended to raise £500 million each year for five years, assuming that standardised packaging is introduced (see Table 2).

43. As Table 2 shows, there is only a marginal difference in the levy per stick required if either none of the levy or all of the levy is assumed to be passed on to the consumer in the retail price (1.24 pence per stick compared to 1.25 pence per stick in year one). These calculations suggest that over three quarters of annual revenue raised through the levy would come from cigarette sales, with the remainder coming from HRT and other tobacco sales.

²⁹ [Impact assessment: standardised packaging of tobacco products](#): Department of Health June 2014

Table 2: Size of tobacco levy required to raise £500 million per year – results, including impact of introducing standardised packaging

All figures in pence

	2015-16	2016-17	2017-18	2018-19	2019-20
Scenario (a): No pass through					
Adult smoking prevalence (%)	17.6	16.7	15.9	15.3	14.7
Cigarette levy (pence per stick)	1.24	1.29	1.34	1.38	1.42
Cigarette levy (per packet of 20)	24.7	25.7	26.8	27.6	28.4
HRT levy (per gramme of tobacco)	1.65	1.72	1.79	1.84	1.89
HRT levy (per 25g packet)	41.2	42.9	44.7	46.0	47.3
Scenario (b): Full pass through					
Adult smoking prevalence (%)	17.4	16.5	15.6	15.1	14.5
Cigarette levy (pence per stick)	1.25	1.30	1.36	1.40	1.44
Cigarette levy (per packet of 20)	25.0	26.0	27.1	27.9	28.7
HRT levy (per gramme of tobacco)	1.67	1.74	1.81	1.86	1.92
HRT levy (per 25g packet)	41.7	43.4	45.2	46.5	47.9

44. The price of tobacco has increased by 80.2% over the last ten years from 2003 to 2013. Using mid-year tobacco prices and average annual earnings net of bonuses, Professor Joy Townsend of the Department of Social and Environmental Health Research at the London School of Hygiene and Tropical Medicine has produced the following “affordability index” for tobacco products (1965 as base year, higher figures indicate greater affordability):³⁰

Affordability Index: Tobacco Products

Above 100 means more affordable, below means less affordable.

1965	100
1980	189
1989	196
1990	185
1995	164
2000	153
2005	157
2006	157
2007	155
2008	154
2009	150
2010	165
2011	130
2012	123
2013	115

45. This calculation suggests that while rises in tobacco taxation have reduced affordability substantially since the late 1980s, there remains considerable scope to reduce affordability further through any price rises that may occur if the industry passes levy

³⁰ Communication with Action on Smoking and Health, 14 January 2015

costs through to the consumer. Price increases are known to be an effective policy lever in reducing smoking prevalence but they need to be accompanied by a comprehensive strategy.

46. During the 1990s when affordability declined consistently year on year in the UK smoking prevalence did not; it remained stubbornly high with over one in four of the adult population smoking. It only began to fall after *Smoking Kills*, the first comprehensive government anti-smoking strategy was introduced from 1999 onwards. In the decade following the introduction of the government strategy smoking rates fell by a quarter from 28% to 21% among all adults³¹ and smoking rates among young people 11-15 years old declined much faster, falling by nearly a half from 11% to 6%.³² In subsequent years with new policy measures regularly being introduced and the government's tobacco control strategy having been updated and improved,^{33 34} smoking rates have continued to decline so that fewer than one in five adults now smoke and only 3% of 11-15 year olds.
47. Two companies: Imperial Tobacco and JTI account for around 80% of sales of tobacco in the UK. Both make large profits and have very large profit margins on their products.⁶ Imperial's UK profits in 2010 were £614m, with a profit margin of more than 67%. JTI's (Gallaher) UK profits in the same year were £345m, with a profit margin of over 38%. British American Tobacco, the world's second largest tobacco company is based in Britain although virtually all of its products are now manufactured outside the UK. In 2013, BAT produced 676 billion cigarettes worldwide and reported an operating profit of £5,526 million, an increase of 3% on 2012.³⁵ It is therefore clear that the tobacco industry could well afford to pay the proposed levy.

Question 11: The government welcomes views on an alternative to a levy that would enable tobacco manufacturers and importers to make a greater contribution.

48. We consider that a levy on tobacco products, with a revenue target per year fixed over five years, is the best policy option at the current time to raise funds for essential tobacco control and enforcement work.
49. However, market failure has given the existing tobacco manufacturers the ability to set prices untroubled by serious competitive threats. In addition, high taxes mean that tobacco industry profits are a small part of the total price. Consequently, significant increases in the pre-tax price make little difference to the price paid by consumers in shops, enabling the industry to increase the price of (and thus profits from) its addictive, price-inelastic product almost at will. Recent evidence from the UK, also suggests the industry is able to absorb taxes on its cheapest cigarette brands (sometimes selling these brands at a loss) by increasing prices and profits on its more expensive brands.³⁶

³¹ Office for National Statistics. [General Lifestyle Survey Overview](#): A report on the 2011 General Lifestyle Survey. 2013.

³² [Smoking drinking and drug use among young people in England in 2013](#). The Information Centre for Health and Social Care, 2014.

³³ [A smokefree future: a comprehensive tobacco control strategy for England](#). HM Government. February 2010.

³⁴ [Healthy Lives, Healthy People: a tobacco control plan for England](#). HM Government. March 2011.

³⁵ BAT Annual Report 2013

³⁶ Gilmore A, Tavakoly B, Taylor G, Reed H. Understanding tobacco industry pricing strategy and whether it undermines tobacco tax policy. The example of the UK cigarette market. *Addiction* 108; (7): 1317-1326.

50. Placing a cap on industry profits would enable the excess profit to be transferred from the manufacturer to government, thus raising substantial resources *in addition* to the current tobacco excise revenues, without placing further burdens on consumers. It would also prevent the industry from absorbing increased taxes on the cheapest brands thereby undermining government tax policy. The means by which this could be achieved is set out in the attached paper by Gilmore et al.³ It is our understanding that this would require revisions to the EU Tobacco Tax Directive, in particular Article 15, and we urge HM Treasury to advocate for the necessary changes when the Directive is next revised.
51. Tobacco is a unique consumer product because it is highly addictive and because a half of lifetime smokers will die from smoking-related disease, including respiratory diseases, circulatory diseases and cancer. About half of all lifelong smokers will die prematurely, losing on average about 10 years of life. This tragic burden of illness and death justifies measures to raise additional funds from large and highly profitable tobacco manufacturers, assuming that sufficient of such funds are used to support evidence-based policy initiatives designed to reduce smoking prevalence by encouraging quitting and discouraging uptake.